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STAFF PAPER

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Project	**Primary Financial Statements**		
Paper topic	EBITDA (Earnings before interest, tax, depreciation and amortisation)		
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Purpose of this paper

1. This paper discusses:

   (a) whether presentation or disclosure of an EBITDA measure should be required by IFRS Standards;

   (b) how the Board's tentative decisions on management performance measures should apply to EBITDA-type measures; and

   (c) when the term 'EBITDA' can be used to describe measures in the financial statements.

2. In this paper we use the term 'EBITDA-type measures' to refer to both adjusted and unadjusted EBITDA measures. By 'unadjusted EBITDA measures', we mean EBITDA-type measures that have only been adjusted for items included in 'ITDA'. By 'adjusted EBITDA' measures, we mean EBITDA-type measures that have also been adjusted for items that do not represent 'ITDA', such as unusual or infrequent items.

Summary of staff recommendations

3. The staff recommend that the Board:

   (a) does not require presentation of EBITDA in the statement(s) of financial performance or disclosure of EBITDA in the notes;

   (b) does not add EBITDA to the list of measures that are not considered to be management performance measures;

   (c) does not exempt specific MPM adjustments from the requirement to disclose the effect of tax and non-controlling interests; and

   (d) specifies that an ‘EBITDA’ label can only be used to describe a measure when the label faithfully represents the content of that measure.

Structure of paper

4. This paper is structured as follows:

   (a) Background (paragraphs 5–11)

      (i) Previous Board discussions and consultation on EBITDA (paragraphs 5–8)

      (ii) Research and outreach on EBITDA (paragraphs 9–11)

   (b) Should the Board require presentation or disclosure of EBITDA? (paragraphs 12–14)

   (c) How should the Board’s tentative decisions on management performance measures apply to EBITDA-type measures? (paragraphs 15–34)

      (i) Should EBITDA be added to the list of measures that are not considered to be management performance measures? (paragraphs 23–28)

      (ii) Should MPM adjustments for specific income and expenses be exempt from the requirement to disclose the effect of tax and non-controlling interests? (paragraphs 29–34)

(d) When can the term 'EBITDA' be used to describe measures in financial statements? (paragraphs 35–42)

(e) Appendix A—Summary of research and outreach on EBITDA

(f) Appendix B—Tentative Board decisions on management performance measures

(g) Appendix C— Summary of June 2018 CMAC/GPF meeting discussion on EBITDA

(h) Appendix D—Illustration of possible subtotal in the statement(s) of financial performance

Background

Previous Board discussions and consultation on EBITDA

5. So far, the Board has not specifically discussed the application of the proposals in the Primary Financial Statements project to EBITDA-type measures[1]. However, the Board has discussed the presentation of EBITDA in the Principles of Disclosure project.

6. The *Disclosure Initiative—Principles of Disclosure* Discussion Paper included the Board's preliminary view that it should clarify that presenting EBITDA as a subtotal in the statement(s) of financial performance:[2]

   (a) can provide a fair presentation if an entity presents an analysis of expenses by nature; but

   (b) is unlikely to achieve a fair presentation if an entity presents an analysis of expenses by function, because such presentation would result in a mixture of the nature of expense and function of expense methods that would disrupt the analysis of expenses.

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[1] EBITDA was excluded from the scope of the Board's most recent discussion on management performance measures (see paragraph 13 of May 2018 Agenda Paper 21C).

[2] See paragraph 5.21(a) of the *Disclosure Initiative—Principles of Disclosure* Discussion Paper.

7. While many respondents to the Discussion Paper agreed with this view in principle, some argued the Board should not explicitly include this guidance in IFRS Standards for various reasons, including[3]:

   (a) some respondents said the existing requirements in IAS 1 *Presentation of Financial Statements* are sufficiently clear; and

   (b) a few respondents said such amendments would be piecemeal and rule-based.

8. Some respondents also commented on the Board's tentative decision in the Primary Financial Statements project to require and define subtotals in the statement(s) of financial performance. Many of those respondents supported the Board defining EBITDA (and EBIT) because they said such measures are useful to users and need to be comparable across entities.

Research and outreach on EBITDA

9. The staff consulted users and preparers at the June 2018 CMAC/GPF meeting and conducted research to gather information about the current use of EBITDA by preparers and users of financial statements. The findings are described in detail in Appendix A.

10. The main findings are that:

    (a) EBITDA-type measures are widely used by preparers and users of financial statements (paragraphs A2–A5 of Appendix A).

    (b) concerns exist about the validity of EBITDA as a measure of performance (paragraph A8 of Appendix A).

    (c) there is diversity in how EBITDA-type measures are defined by preparers and users of financial statements. How an EBITDA-type measure is defined is often not apparent from its label (paragraphs A9–A13 of Appendix A).

[3] See paragraphs 10–19 of February 2018 Agenda Paper 11I for a full summary of feedback on EBITDA received in response to the Discussion Paper.

11. A full summary of the June 2018 CMAC/GPF discussion is included in Appendix C.

Should the Board require presentation or disclosure of EBITDA?

12. The Board may want to consider requiring presentation or disclosure of EBITDA because:

    (a) our research and outreach have shown that EBITDA is a widely used measure by investors (see paragraph A5 of Appendix A);

    (b) not all entities disclose an EBITDA-type measure (see paragraph A3 of Appendix A). When it is disclosed, EBITDA may not be comparable across entities (see paragraph A9 of Appendix A).

    (c) some stakeholders have asked us to require EBITDA, including a few respondents to the *Disclosure Initiative—Principles of Disclosure* Discussion Paper.

13. However, the staff recommend that the Board should not require presentation of EBITDA in the statement(s) of financial performance because:

    (a) EBITDA-type measures would not fit in the structure of the statement(s) of financial performance as defined in this project for *all* entities. In our view, only if the following conditions are satisfied could an EBITDA-type measure be presented as a subtotal in the statement(s) of financial performance:

        (i) the measure complies with the requirements in paragraphs 85 and 85A of IAS 1—including that presentation of the measure must be relevant to an understanding of the entity’s financial performance;

        (ii) the entity presents an analysis of expenses by nature; and

        (iii) the measure is defined as operating profit plus depreciation and amortisation.

    The presentation of such a subtotal is illustrated in Appendix D. Requiring EBITDA only for entities that analyse expenses by nature would not result in comparability across entities and might put pressure on the assessment of whether to analyse expenses by function or by nature.

(b) requiring EBITDA to be presented in the statement(s) of financial performance may give undue prominence to this measure, given the concerns raised by some stakeholders about the validity of EBITDA as a measure of performance (see paragraph A8 of Appendix A).

14. In addition, the staff recommend that the Board should not require disclosure of EBITDA in the notes because:

(a) given the concerns raised by some stakeholders about the validity of EBITDA as a measure of performance (see paragraph A8 of Appendix A) it may not be appropriate to require entities to disclose this measure. Some CMAC and GPF members shared this view (see paragraphs C2(b)(i) and C3 of Appendix C).

(b) while depreciation and amortisation are not required line items, they are required to be disclosed separately[4]. Consequently, if users find EDITDA-type measures useful, they can calculate them themselves, starting from one of the defined subtotals in the statement(s) of financial performance.

(c) if the Board decided to require EBITDA, the Board would arguably also need to define or describe EBITDA. Paragraph 27(b) explains why the staff think describing EBITDA would be difficult for the Board.

(d) the Board would need to consider the scope of such a requirement, for example whether financial entities should be exempt, which would add complexity to our proposals.

[4] For example, see paragraph 73(e)(vii) of IAS 16 *Property, Plant and Equipment* and paragraph 118(e)(vi) of IAS 38 *Intangible Assets* and paragraph 104 of IAS 1.

Question 1
Does the Board agree with the staff recommendation that the Board should not require presentation of EBITDA in the statement(s) of financial performance or disclosure of EBITDA in the notes?

How should the Board's tentative decisions on management performance measures apply to EBITDA-type measures?

15. If the Board agrees with the staff recommendation in the previous section not to require presentation or disclosure of EBITDA, entities could still disclose an EBITDA-type measure in the notes, for example by identifying it as a management performance measure. This section considers how the Board's tentative decisions on management performance measures should apply to EBITDA-type measures.

16. In our research we have found that EBITDA-type measures are mainly included in the financial statements in the following ways (see paragraph A4 of Appendix A):
    (a) as a segment measure of profit or loss, in accordance with paragraph 23 of IFRS 8 *Operating Segments*;
    (b) in disclosures about capital management and debt—for example describing the requirements of debt covenants or describing a target capital structure (eg net debt/EBITDA < 2);
    (c) as a subtotal in the statement(s) of financial performance, in accordance with paragraph 85 and 85A of IAS 1; and
    (d) as a subtotal in the statement of cash flows, when the indirect method is used.

17. Entities may identify some of these measures as management performance measures. In addition, some of the EBITDA-type measures currently only disclosed outside the financial statements may be identified as management performance measures.

18. Applying the Board's tentative decisions on management performance measures to such EBITDA-type measures would mean that entities are:

    (a) required to disclose such EBITDA-type measures in the notes to the financial statements; and

    (b) required to provide a set of disclosures ('MPM disclosures') (see paragraphs B1(b)–(c) of Appendix B), including:

        (i) a reconciliation of the EBITDA-type measure to the closest total or subtotal specified by IFRS Standards; and

        (ii) disclosure of the effect of tax and non-controlling interests for each of the adjustments in the reconciliation—including depreciation and amortisation.

19. The staff think the outcome in paragraph 18 is generally appropriate. Considering the current diversity in EBITDA definitions in financial reporting (see paragraph A9), MPM disclosures will be helpful to provide useful information to users of financial statements about how an entity has calculated an EBITDA-type measure.

20. However, the staff think the disclosure of the effect of tax and non-controlling interests for depreciation and amortisation may be unnecessary. Users would only need these effects if they wanted to calculate a performance measure before depreciation and amortisation that is post-tax and attributable to owners of the parent. However, the staff have not seen evidence of users calculating such measures.

21. It may be difficult and costly for preparers to provide the effect of tax and non-controlling interests for depreciation and amortisation.

22. The staff have identified the following two ways in which the disclosure of the effect of tax and non-controlling interests for depreciation and amortisation could be avoided:

    (a) the Board could describe EBITDA and add it to the list of measures that are not considered to be management performance measures, such as gross profit (see paragraph B2 of Appendix B) (paragraphs 23–28).

(b) the Board could specify a list of management performance measure adjustments for which the disclosure of the effect of tax and non-controlling interests is not required (paragraphs 29–34).

Should EBITDA be added to the list of measures that are not considered to be management performance measures?

23. The Board could describe EBITDA and add it to the list of measures that are not considered to be management performance measures. Consequently, none of the MPM disclosures would be required for EBITDA-type measures that comply with the Board's description.

24. The Board could describe EBITDA in different ways, including by:

  (a) describing EBITDA as 'profit or loss minus all interest income and plus all interest expenses, income tax and depreciation and amortisation expenses'.

  (b) building on the existing definition of 'profit before financing and income tax' and describing EBITDA as 'profit before financing and income tax plus depreciation and amortisation'.

  (c) building on the existing definition of 'operating profit' and describing EBITDA as 'operating profit plus depreciation and amortisation'. Such a measure could fit as a subtotal in the structure of the statement(s) of financial performance in some circumstances (see paragraph 13(a) and Appendix D).

25. Describing EBITDA would also mean the Board takes ownership of a widely used measure and ensures that, when disclosed, it is calculated consistently.

26. EBITDA-type measures that do not comply with the Board's description would be considered management performance measures, for which the MPM disclosures would be required—including a reconciliation to the closest measure required or described by IFRS Standards. If the entity reconciles its EBITDA-type measure to EBITDA as described by the Board (in case it is the most comparable measure for the MPM to reconcile to), depreciation and amortisation would not appear in the MPM reconciliation. In such cases, the effect of tax and non-controlling interests would not have to be disclosed for depreciation and amortisation.

27. However, the staff recommend EBITDA should not be added to the list of measures that are not considered to be management performance measures because:

    (a) it provides a special treatment for EBITDA compared to other performance measures. This may not be appropriate considering the concerns some stakeholders have raised about the validity of EBITDA as a measure of performance (see paragraph A8 of Appendix A).

    (b) it would be difficult for the Board to describe EBITDA, because of conflicting considerations:

        (i) describing EBITDA would mean the Board is also describing EBIT, something the Board has decided not to do on the project so far, instead focussing on defining profit before financing and tax because it was thought to provide more useful information than EBIT;

        (ii) describing EBITDA as suggested in paragraph 24(a) may be considered to provide the most faithful representation of the measure; however

        (iii) describing EBITDA as suggested in paragraph 24(b)or 24(c) may be considered to provide more useful information.

28. The staff therefore recommend that the Board should not add EBITDA to the list of measures that are not considered to be management performance measures.

Question 2
Does the Board agree with the staff recommendation that EBITDA should not be added to the list of measures that are not considered to be management performance measures?

Should MPM adjustments for specific income and expenses be exempt from the requirement to disclose the effect of tax and non-controlling interests?

29. If the Board agrees with the staff recommendation to not exempt EBITDA from the scope of MPM disclosures, the Board could specify a list of income and

expenses for which, if adjusted in an MPM, disclosure of the effect of tax and non-controlling interests is not required. That list could include depreciation and amortisation.

30. The Board's rationale for requiring disclosure of the effect of tax and non-controlling interests was that it allows users to calculate their own adjusted measures on a post-tax basis, excluding non-controlling interests. For example, an entity might disclose an adjusted operating profit measure excluding both restructuring and share-based payment expenses, which its management identifies as their management performance measure. For the purpose of developing an EPS figure for their analysis, users might want to retain management's adjustment to exclude restructuring expenses, but they might not want to adjust for share-based payment expenses. If users are given information about the effect of tax and non-controlling interests on the restructuring expense, they can calculate their own adjusted EPS measure. In other words, disclosure of the effect of tax and non-controlling interests is only useful for those management adjustments that users may want to retain when calculating an adjusted profit after tax or an adjusted EPS measure.

31. However, the staff were not able to determine a conceptual basis for identifying such 'useful' management adjustments that users may want to retain. For example, we considered whether investors were only interested in the effect of tax and non-controlling interests for adjustments that can be described as 'non-recurring' but concluded this was not always the case. In our view, whether an adjustment is considered useful may depend on an investor's approach to analysis. An investor survey by the CFA Institute (2016) found that there are some adjustments for which there is no consensus among users about whether they are appropriate or not[5].

32. In the absence of a principle describing adjustments for which information on tax and non-controlling interests is useful, the staff think that the Board could simply

[5] See V. Papa and S. Peters, 'Investor uses, expectations and concerns on non-GAAP financial measures', CFA Institute, 2016, p. 31, accessible at: https://www.cfainstitute.org/en/advocacy/policy-positions/investor-uses-expectations-and-concerns-on-non-gaap-financial-measures.

specify that tax and non-controlling interests disclosure is not required for depreciation and amortisation adjustments.

33. However, it may not be appropriate to provide an exemption for depreciation and amortisation expenses on *all* assets. For example, some investors adjust for amortisation of some acquired intangibles in their analysis[6,7] and may consequently be interested in the effect of tax and non-controlling interests on that type of amortisation.

34. Consequently, the staff recommend not to exempt specific MPM adjustments from the requirement to disclose the effect of tax and non-controlling interests.

Question 3
Does the Board agree with the staff recommendation that the Board should not exempt specific MPM adjustments from the requirement to disclose the effect of tax and non-controlling interests?

When can the term 'EBITDA' be used to describe measures in financial statements?

35. At its October 2018 meeting, the Board tentatively decided to clarify, possibly using an example, when the term 'EBIT' can be used to describe performance measures in financial statements. The staff think a similar clarification about the use of the term EBITDA would be useful because descriptions used for EBITDA-type measures today do not always reflect their content (see paragraph A10 of appendix A).

36. Paragraph 15 of IAS 1 requires fair presentation of information in the financial statements. The staff think that it follows that the label used to describe a measure

[6] See V. Papa and S. Peters, p.31. 30.4% of surveyed CFA members said adjustments for acquired intangibles were usually appropriate. 38.7% said such adjustments are sometimes appropriate.

[7] In the Goodwill and Impairment project, the Board is considering whether to require disclosure of the amount of equity an entity would report if it did not recognise goodwill and those acquired intangible assets that would not have been recognised if they had been internally generated and to disclose the profit or loss an entity would report without amortisation and without any impairment losses on those intangible assets and on goodwill. Some argue that this idea could allow investors to better compare the performance of entities growing organically with entities growing through acquisitions. (see paragraph 26 of October 2018 Agenda Paper 18A).

that is disclosed in the financial statements should faithfully represent what is included in that measure, regardless of whether such a measure is identified as an MPM.

37. In addition, the Board has tentatively decided to require entities to describe an MPM in a way which is not misleading.

38. Therefore, and to be consistent with the Board's discussion on EBIT in October 2018, the staff think that the term EBITDA can only be used to describe a measure within financial statements when it is a 'true' EBITDA, ie it is equivalent to profit or loss, minus all interest income and plus all interest expenses, income tax and depreciation and amortisation. The content of 'all interest income/expenses' is expected to be different from the income and expenses presented below the 'profit before financing and income tax' subtotal, because 'profit before financing and income tax' does not exclude *all* interest, nor does it exclude *only* interest.

39. Consequently, the staff think a measure could *not* be faithfully represented by the 'EBITDA' label if:

    (a) unusual or infrequent items such as restructuring and relocation expenses are added back. Our research suggests that EBITDA-type measures are often adjusted for items considered to be infrequent (see paragraph A9 of Appendix A).

    (b) the measure excludes the share of profit or loss of associates and joint ventures. Our research suggests that EBITDA-type measures often exclude the share of profit or loss of associates and joint ventures (see paragraph A9 of Appendix A).

    (c) the measure is adjusted for impairment. Our research suggests that EBITDA-type measures often exclude impairment as part of 'DA' (see paragraph A9 of Appendix A).

    (d) the measure does not exclude all depreciation and amortisation expenses—for example it only excludes amortisation of acquired intangible assets.

40. Nevertheless, entities could use modified forms of EBITDA to describe their performance measures, such as ‘adjusted EBITDA’, if such a description faithfully represents the measure.

41. The staff therefore propose to clarify that an ‘EBITDA’ label can only be used to describe a measure in the financial statements when the label faithfully represents the content of that measure, meaning that an EBITDA label can only be used to describe a measure that has been calculated as profit or loss minus all interest income and plus all interest expenses, income tax and depreciation and amortisation.

42. This clarification would apply to all EBITDA-type measures—including those disclosed as management performance measures, as well as those disclosed in accordance with other disclosure requirements of IFRS Standards (see paragraph 16).

Question 4
Does the Board agree with the staff recommendation that the Board should clarify that an ‘EBITDA’ label can only be used to describe a measure in the financial statements when the label faithfully represents the content of that measure?

Appendix A—Summary of research and outreach on EBITDA

A1. The staff consulted stakeholders at the June 2018 CMAC/GPF meeting[8] and conducted research to gather information about:

(a) the use of EBITDA by preparers and users of financial statements (paragraphs A2–A5);

(b) the usefulness of EBITDA as a measure of performance (paragraphs A6–A8); and

(c) diversity in EBITDA definitions and labelling (paragraphs A9–A13).

Use of EBITDA

A2. Both our research and outreach confirmed that EBITDA is widely used by:

(a) entities in their financial statements and other financial reporting materials (see paragraph A3–A4);

(d) investors, analysts and lenders in financial analysis (see paragraph A5); and

(e) lenders and borrowers in debt contracting[9].

A3. The staff reviewed annual reports and other financial reporting materials (for example transcripts and presentations for earnings calls) of 85 entities applying IFRS Standards, across a range of industries (excluding financial entities) and geographies. The staff found that:

(a) 13 entities do not use EBITDA inside or outside the financial statements;

(f) 72 entities use EBITDA. Among these entities:

(i) 41 entities use EBITDA both inside and outside the financial statements;

[8] The full summary of the June 2018 CMAC/GPF discussion is included in Appendix C.

[9] N. Li, ‘Performance Measures in Earnings-Based Financial Covenants’, *Journal of Accounting Research*, Vol 54 No.4., September 2016.

(ii) one entity uses EBITDA only inside the financial statements.

(iii) 30 entities use EBITDA only outside the financial statements.

A4. For the 42 entities who use EBITDA inside the financial statements, we found that:

(a) EBITDA was most often used as a segment measure of performance (23 entities) or in disclosures about capital structure and debt (18 entities)—for example describing the requirements of debt covenants or describing a target capital structure (eg net debt/EBITDA < 2).

(b) four entities presented EBITDA as a subtotal in the statement(s) of financial performance.

(c) two entities presented EBITDA as a subtotal in the statement of cash flows using the indirect method.

(d) 30 entities used the 'function of expense' method (71%), whereas 12 entities use the 'nature of expense' method (29%).

A5. An investor survey by the CFA Institute[10] found that 69.8% use unadjusted EBITDA and 65.9% use adjusted EBITDA. In comparison, 45.9% use EBIT and 38.3% use adjusted EBIT. An investor survey by Cascino et al (2016)[11] also confirmed the popularity of EBITDA as a performance measure among investors, because of its perceived predictive ability.

Usefulness of EBITDA

A6. The staff understand that investors, analysts and lenders use EBITDA in similar ways to EBIT, including in:

[10] V. Papa and S. Peters, 2016, p21. The sample of 431 respondents consists of 287 portfolio managers and buy-side analysts and 144 sell-side analysts and other users.

[11] The sample consists of 81 mostly European, professional investors. See S. Cascino, M. Clatworthy, B. Garcia Osma, J. Gassen, S. Imam and T. Jeanjean 'Professional investors and the decision usefulness of financial reporting', 2016, Report prepared for ICAS (The Institute of Chartered Accountants of Scotland) and EFRAG (European Financial Reporting Advisory Group), pp 34-39, accessible at: https://www.icas.com/__data/assets/pdf_file/0010/236764/Professional-investors-and-the-decision-usefulness-of-financial-reporting.pdf

(a) financial performance comparison—EBITDA is used to compare the historical financial performance of different entities, for example by analysing EBITDA margin (EBITDA/Revenue) and EBITDA growth;

(g) assessing debt service capability (solvency and credit risk), for example by analysing the interest coverage ratio (EBITDA/Interest expense) and net debt/EBITDA ratio. Such ratios based on EBITDA are often included in debt covenants;

(h) multiples analysis—EBITDA is used in calculating the Enterprise Value/EBITDA multiple; and

(i) forecasting—some use EBITDA as a starting point for forecasting operating cash flows.

A7. The staff understand that some investors, analysts and lenders prefer using EBITDA rather than EBIT in these types of analysis for reasons including the following:

(a) to adjust for non-cash expenses in order to obtain a proxy of operating cash flows; and

(j) to eliminate distortions caused by differences in depreciation policies between entities.

A8. However, some stakeholders and some research highlight concerns about the use of EBITDA for:

(b) assessing debt service capability/solvency—interest coverage based on EBITDA can be overstated because it does not take into account cash needed for capital expenditures.

(k) multiples analysis— the EV/EBIT multiple may be more appropriate than EV/EBITDA when capital intensity varies significantly among the entities being compared.

(l) forecasting operating cash flows— EBITDA may not be a good proxy for operating cash flows. Further adjustments may be required, including adjustments for working capital movements and other accruals..

Diversity in EBITDA definitions and labelling

A9. Among the 72 entities described in paragraph A3(b) there is diversity in the way entities define EBITDA-type measures:

(a) some entities add back other non-cash expenses as part of ‘DA’ that are akin to depreciation and amortisation, for example 23 entities added back impairment.

(b) similarly to EBIT, there is diversity in the definition of ‘I’[12]. For example some include net interest on net defined benefit liabilities in EBITDA, others exclude it.

(c) similarly to EBIT, there is diversity whether the measure includes or excludes the share of profit of associates and joint ventures:

(i) 18 entities included the share of profit of associates and joint ventures in EBIT;

(ii) 21 entities excluded it from EBITDA; and

(iii) the other 33 entities either did not have associates or joint ventures or we were not able to determine whether the share of profit or loss of associates and joint ventures was included in or excluded from EBITDA.

(d) various adjustments are made for unusual or infrequent items.

A10. Among the 72 entities described in paragraph A3(b):

(a) 16 of the 72 entities reflected adjustments in the labelling of their EBITDA-measures—for example referring to their measure as ‘adjusted EBITDA’ or ‘underlying EBITDA’.

(m) 30 of the 72 entities used the label ‘EBITDA’—among those:

(i) 4 entities comply with the description of EBITDA as proposed in paragraph 41; and

(ii) 26 entities use a different definition of EBITDA—those entities would not be able to use the label ‘EBITDA’ in

[12] Many entities’ definition of ‘I’ in EBITDA corresponds to their definition of ‘finance income and expenses’ in the statement(s) of financial performance. Appendix A of the March 2017 Agenda Paper 21A includes research findings on the content of ‘finance income/expenses’ for a sample of 25 entities.

the financial statements under the proposal in paragraph 41.

(n) for the other 26 entities, no definition was provided, and the staff were not able to assess whether entities' definitions comply with the description in paragraph 41. This mostly included cases where EBITDA was only used outside the financial statements.

A11. A few respondents to the *Disclosure Initiative—Principles of Disclosure* Discussion Paper reported similar findings as those in paragraph A9.

A12. The staff have also found diversity in EBITDA definitions used by investors and other users of financial statements such as credit rating agencies. For example:

(a) some exclude the share of profit or loss of associates and joint ventures from EBITDA;

(o) some replace the share of profit or loss of associates and joint ventures with dividends received from associates and joint ventures in the calculation of EBITDA; and

(p) some include the share of profit or loss of associates and joint ventures in EBITDA when the associate or joint venture is considered to be an integral part of the company's income-generating operations and the equity-accounted income is deemed to be sufficiently backed by cash distributions from the associates or joint ventures.

A13. In addition, there is diversity in the EBITDA definitions used in loan covenants[13] and documents for marketing debt issuance. EBITDA definitions in these documents often include various forward-looking adjustments (eg future cost savings and synergies) that are loosely defined[14].

[13] See N. Li, 2016, p. 1178-1179.

[14] See Standard & Poors, 'When The Credit Cycle Turns: The EBITDA Add-Back Fallacy, 2018.

Appendix B—Tentative Board decisions on management performance measures

B1. The Board discussed requirements for management performance measures at its meetings between January and May 2018. At those meetings, the Board tentatively decided that:

(a) all entities shall identify a measure (or measures) of profit or comprehensive income that, in the view of management, communicates to users the financial performance of the entity. This measure will:

(i) often only be a subtotal or total specified by paragraph 81A of IAS 1.

(ii) sometimes be identified by management as a measure that is not a subtotal or total specified by paragraph 81A of IAS 1, but would complement those subtotals or totals. Such a measure is a management performance measure.

(q) the following requirements apply to management performance measures described in paragraph a(ii):

(i) a reconciliation would be provided in the notes between that measure and the most directly comparable subtotal or total specified by paragraph 81A of IAS 1;

(ii) the effect of tax and non-controlling interests for each of the differences between that measure and the most directly comparable subtotal or total specified by paragraph 81A of IAS 1 would be disclosed in the notes;

(iii) that there should be no specific constraints on management performance measures;

(iv) the measure would be labelled in a clear and understandable way so as not to mislead users; and

(v) the following information is required to be disclosed:

1. a statement that the measure provides management's view of the entity's financial performance and is not necessarily comparable with measures provided by other entities;

2. a description of why the management performance measure provides management's view of performance, including an explanation of how the management performance measure has been calculated and why and how the measure provides useful information about an entity's financial performance; and

3. sufficient explanation, if there is a change in how the management performance measure is calculated during the year, to help users understand the reasons for and effect of the change.

(r) that the reconciliation between the management performance measure and the most directly comparable subtotal or total specified by paragraph 81A of IAS 1 should be provided separately from the operating segment information disclosed in accordance with IFRS 8 *Operating Segments*. However, entities would not be prohibited from also including management performance measures within the operating segment information. Furthermore, the following information would be required to be disclosed:

(i) an explanation of how the management performance measure differs from the total of the measures of profit or loss for the reportable segments; and

(ii) if none of the management performance measures fits into the operating segment information, an explanation of why this is the case.

B2. For the purposes of these proposals, paragraph 81A of IAS 1 would include the existing subtotals in that paragraph and the proposed new required subtotals developed as part of this project, for example operating profit. The Board tentatively decided to expand the list of subtotals and totals that would not be considered management performance measures to include the following commonly used subtotals: profit before tax, profit from continuing operations, and gross profit, described as revenue less cost of sales. The Board members advised caution in drafting to clearly distinguish these three commonly used subtotals from those that are specifically required to be presented by all entities in paragraph 81A of IAS 1.

B3. The Board also asked the staff to clarify in drafting that management performance measures provide additional information that complements the subtotals and totals specified by paragraph 81A of IAS 1, rather than provides a better view of financial performance.

Appendix C—Summary of June 2018 CMAC/GPF meeting discussion on EBITDA

C1. Many members said that EBITDA is widely used by investors, analysts and lenders. However, members expressed mixed views on the usefulness of EBITDA as a performance measure:

(a) some members said EBITDA is a useful starting point for various types of analysis, in particular analysis of creditworthiness, as EBITDA is used as a proxy for operating cash flows.

(b) some members said EBITDA had significant shortcomings as a performance measure. Some GPF members said that EBITDA is a poor proxy for operating cash flows and will become a worse proxy as a result of IFRS 15 *Revenue from Contracts with Customers* and IFRS 16 *Leases*.

(c) some members said EBITDA can be misleading today as it is frequently adjusted for items other than interest, tax, depreciation and amortisation.

C2. Members expressed mixed views on whether the Board should define EBITDA:

(a) some members supported the Board defining EBITDA because:

(i) given that the Board has already defined a measure that is similar to EBIT (ie profit before financing and income tax), defining EBITDA would be a logical next step and would not require much additional effort.

(ii) there is some diversity in how entities currently calculate EBITDA. Some members said an EBITDA measure defined by the Board would be helpful because it would provide a comparable starting point. Some members said that entities should be allowed to make further adjustments to EBITDA as defined by the Board, but such measures would have to be labelled ‘adjusted EBITDA’.

(b) other members did not support the Board defining EBITDA because:

(i) it would potentially promote the use of EBITDA. They did not support this because they did not consider EBITDA to be a useful performance measure.

(ii) it is a low priority issue; defining EBITDA would not be a good use of the Board’s limited time and resources.

C3. Some members said the Board should allow rather than require EBITDA to be disclosed. Some members also said EBITDA should only be allowed to be disclosed in the notes; it should not be presented in the statement(s) of financial performance.

Appendix D—Illustration of possible subtotal in the statement(s) of financial performance

Statement of profit or loss presented by nature	
Revenue	15,500
Changes in inventories of finished goods and work in progress	-1,000
Work performed by the entity and capitalised	1,000
Raw material and consumables used	-6,000
Employee benefits expense	-4,000
Impairment of property, plant and equipment	-500
Operating profit before depreciation and amortisation	**5,000**
Depreciation expense	-1,200
Amortisation expense	-800
Operating profit	**3,000**
Share of profit of **integral** joint ventures and associates	500
Operating profit and share of profit from integral associates and joint ventures	**3,500**
Changes in the fair value of financial assets	250
Dividend income	50
Share of profit of **non-integral** joint ventures and associates	100
Profit before financing and income tax	**3,900**
Interest income from cash and cash equivalents calculated using effective interest method	80
Other income from cash and cash equivalents and financing activities	20
Expenses from financing activities	-1000
Other finance income	50
Other finance expenses	-350
Profit before tax	2,700